(10)

FILED
FEB 9 1942
CHARLES ELMORE CROPLEY
CLERK

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1941

No. 934

NELSON TAYLOR, J. R. MASON, GILBERT MOODY, and N. O. BOWMAN,
Petitioners,

vs.

PROVIDENT IRRIGATION DISTRICT,
Respondent.

PETITION FOR WRIT OF CERTIORARI
to the United States Circuit Court of Appeals
for the Ninth Circuit
and
BRIEF IN SUPPORT THEREOF.

W. COBURN COOK,
Berg Building, Turlock, California,
Counsel for Petitioners.

PRESNAU-WALSH PRINTING CO., SAN FRANCISCO, CALIFORNIA

Subject Index

	Page
Opinions Below	2
Jurisdiction	2
Statutes Involved	2
Summary Statement of the Matter Involved	3
Our view of the case	5
Questions Presented	8
Reasons for Granting Writ of Certiorari	9
Brief in Support of Petition for Writ of Certiorari	13
Factual Background of Case	13
I.	
The plan is unfair and discriminatory as to petitioner Nelson Taylor	13
II.	
The highest court of California has established the facts and law of this proceeding and the bankruptcy court was bound to follow such decisions, but did not	16
III.	
The plan is unfair and discriminatory to petitioners	18
Conclusion	22

Table of Authorities Cited

Cases	Pages
American Un. Mut. Life Ins. Co. v. City of Avon Park, 311 U. S. 138	10, 11
American United Mutual Life Ins. Co. v. City of Avon Park, 108 Fed. (2d) 1010, 61 S. Ct. 157	7
Anderson-Cottonwood v. Klukkert, 13 Cal. (2d) 191	19
Arkansas Corporation Comm. v. Thompson, 313 U. S. 132	21
Bates v. McHenry, 123 Cal. App. 81	5, 14
Carter v. Carter Coal Co., 298 U. S. 238	21
Case v. Los Angeles Lumber Products Co., 308 U. S. 106	10, 11
Consolidated Rock Products Company v. Du Bois, 312 U. S. 510	10, 11, 18
Cusick v. Second Nat. Bank, 115 Fed. (2d) 150	8
Erie Railroad v. Tompkins, 304 U. S. 64	10, 11, 17
Ginsberg v. Lindel, 107 Fed. (2d) 721	7, 17
Ill. Centr. R. Co. v. Illinois, 146 U. S. 387	21
Lowmon, In re, 79 Fed. (2d) 887	14
Moody v. Provident Irrigation District, 12 Cal. (2d) 389	6, 7, 9, 16
Mt. Forest Fur Farms, In re, 122 Fed. (2d) 232	17
Preble Corp. v. Wentworth, 84 Fed. (2d) 73	18
Provident Land Corp. v. Zumwalt, 12 Cal. (2d) 365	5, 6, 7, 9, 10, 14, 15, 16, 18, 19, 21
Roberts v. Board of Public Instruction, 117 Fed. (2d) 943	6
Security First National Bank v. Rindge Land & Nav. Co., 85 Fed. (2d) 557	18
Wilson v. Standifer, 184 U. S. 399	17

Codes and Statutes

	Pages
Bankruptcy Act of 1898, Chapter IX (11 U. S. C. Sec. 401-404)	3
Bankruptcy Act of June 22, 1938, c. 575, Sec. 3(b) (52 Stat. 940)	2
Bankruptcy Act of August 16, 1937, c. 657 (50 Stat. 654), 11 U. S. C. 401-404, adding Sections 81-84	2
Bankruptcy Act, Section 403 (a)	6
Bankruptcy Act, Section 403 (d)	4
Bankruptcy Act, Section 403 (e)	4, 7
California Districts Securities Commission Act, Cal. Stat. 1931, p. 2263	2
California Irrigation District Act, Cal. Stat. 1897, p. 254	2, 3
California Irrigation District Act, Secs. 17, 29, 74-80, Cal. Stat. 1897, p. 243	21
California Irrigation District Act, Sec. 47	21
California Irrigation District Act, Secs. 74-84	7
Cal. Stat. 1931, p. 172	14
Judicial Code, Section 240 (a) (28 U. S. C., para. 347(a))	2
Municipal Bankruptcy Act of May 24, 1934, c. 345 (48 Stat. 798), 11 U. S. C. 301-303, adding Sections 78-80 to the Bankruptcy Act of 1898	2
Political Code of California, Section 3773	20

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1941

No.

NELSON TAYLOR, J. R. MASON, GILBERT MOODY, and N. O. BOWMAN,
Petitioners,

vs.

PROVIDENT IRRIGATION DISTRICT,
Respondent.

PETITION FOR WRIT OF CERTIORARI
to the United States Circuit Court of Appeals
for the Ninth Circuit.

To the Honorable Harlan F. Stone, Chief Justice of the United States, and to the Associate Justices of the Supreme Court of the United States:

Petitioners pray that a writ of certiorari issue to review the decision (R. 234) of the Circuit Court of Appeals of the Ninth Circuit made in the above entitled cause on December 4, 1941, which affirmed the

interlocutory decree of the District Court of the Northern District of California, Northern Division, rendered against petitioners on January 21, 1941. (R. 200.)

OPINIONS BELOW.

Opinion of the Circuit Court of Appeals, ... Fed. (2d) ..... (R. 234.)

JURISDICTION.

The decision in the Circuit Court of Appeals was rendered December 4, 1941. (R. 234.) The mandate was stayed until disposition of the case by this Court. (R. 244.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code (28 U. S. C., paragraph 347 (a)).

STATUTES INVOLVED.

Municipal Bankruptcy Act of May 24, 1934, c. 345 (48 Stat. 798), 11 U. S. C. 301-303, adding Sections 78-80 to the Bankruptcy Act of 1898; Act of August 16, 1937, c. 657 (50 Stat. 654), 11 U. S. C. 401-404, adding Sections 81-84; and Act of June 22, 1938, c. 575, Sec. 3 (b) (52 Stat. 940). Principal California statutes involved are "the California Irrigation District Act", Cal. Stat. 1897, p. 254 as amended; the "California Districts Securities Commission Act", Cal. Stat. 1931, p. 2263 as amended.

SUMMARY STATEMENT OF THE MATTER INVOLVED.

This is a proceeding brought by the respondent Provident Irrigation District, a California irrigation district, for confirmation of composition of debts under Chapter IX of the Bankruptcy Act of 1898 as amended. (11 U. S. C. Sec. 401-404.)

The matter came on before the Court for hearing on November 18, 1940 on the petition filed by the Provident Irrigation District, hereinafter called the district, the petition having been filed May 29, 1940, and the answer and objections to the petition.

The district, a state agency, was organized in 1918 pursuant to the California Irrigation District Act (Cal. Stat. 1897, p. 254, as amended), is located in the counties of Glenn and Colusa in California, and comprises approximately 22,805 acres. In 1918 the district issued a first issue of general obligation coupon bonds in the amount of $1,000,000 and in 1921 a second issue of $190,000, all bearing interest at 6%. Present outstanding indebtedness is $957,000. At the time of the hearing $341,000 of this amount had matured and interest coupons in the amount of $415,192.50 had matured and were unpaid. Total outstanding indebtedness of the district was $1,400,672.50. The district applied to the Reconstruction Finance Corporation for a loan and on December 20, 1939, was granted such in the amount of $193,500. The plan offered to the bondholders 20 cents for each dollar of unpaid principal amount of the old bonds, plus the full amount of any interest coupons prior to July 1, 1931. The terms of the loan provided among other things that the district

was to reduce its size to approximately 13,000 acres. The petitioners have resisted the plan and the proceedings in the courts relative thereto, and own principal of bonds as follows: Nelson Taylor $3000; J. R. Mason $17,000; Gilbert Moody $3000; N. O. Bowman $9000.

The Nelson Taylor bonds matured August 15, 1930 and were presented for payment January 30, 1931 but not paid. Other bonds, later in maturities and presentations, were paid in full. Taylor's bonds, due in 1930 were evidently not paid because the district took the erroneous position that they were "outlawed". (R. 181.) There are no other unpaid bonds of the 1930 maturity.

The fiscal agent for the district was to receive $20,-300 for his services. (R. 123.)

The Bankruptcy Act (Sec. 403 (e)), provides that a plan may be confirmed if "(1) it is fair, equitable, and for the best interests of the creditors and does not discriminate unfairly in favor of any creditor or class of creditors; (2) complies with the provisions of this chapter; (3) has been accepted and approved as required by the provisions of subdivision (d) of this section; (4) all amounts to be paid by the petitioner for services or expenses incident to the composition have been fully disclosed and are reasonable; (5) the offer of the plan and its acceptance are in good faith; and (6) the petitioner is authorized by law to take all action necessary to be taken by it to carry out the plan."

Also, that "(i) Nothing contained in this chapter shall be construed to limit or impair the power of any

State to control, by legislation or otherwise, any municipality or any political subdivision of or in such State in the exercise of its political or governmental powers, including expenditures therefor."

Our view of the case.

The plan of composition provides for the payment of obligations of the district maturing up to and including January 1, 1931 in full, but does not provide for the payment in full of the bonds of Nelson Taylor, amounting to $3000 which matured August 15, 1930, and which the district admittedly should have paid prior to filing in bankruptcy.

Other bonds of the same and later maturities and presentations were paid in full. (R. 118, 181, 189.) Many interest coupons of later presentations than Taylor's bonds were paid in full, and in fact the plan is that all coupons of January 1, 1931 maturity are to be paid in full. This is directly contrary to *Bates v. McHenry,* 123 Cal. App. 81, and *Provident Land Corp. v. Zumwalt,* 12 Cal. (2d) 365,[1] which held that payment must be in order of presentation. At the time of the latter case, the district had a "surplus" of $10,000 (R. 179), and under the law as declared by the highest court of California payment should have been made to Taylor from that money before any bonds or interest coupons of later presentations were paid. At the time of the bankruptcy hearing, the district had that $10,000 and also $5500 in redemption money. The "plan" wholly disregards this right by

[1]This case is set forth in the Appendix p. i, substantially in full.

providing for payment in full of all January 1, 1931 interest coupons regardless of their later maturity and regardless of their dates of presentation for payment. The record indicates (R. 67) that most of the January 1, 1931 coupons are in the hands of one man. This should have prompted an inquiry under the rule of *Roberts v. Board of Public Instruction,* 117 Fed. (2d) 943.

But the essential fact is that Nelson Taylor's bonds through error or deliberately were not paid prior to the bankruptcy petition. They admittedly should have been so paid. The bankruptcy petition and decree do not right this wrong but condone it. Equity and right could be done and should be done.

The case of *Moody v. Provident Irrigation District,* 12 Cal. (2d) 389, in effect holds that after presentation for payment bond obligations of California irrigation districts are not due until funds are on hand available for payment. The bonds involved in that case are the same held in this case by Moody. The district is therefore able to meet its debts as they mature and the inability required by Bankruptcy Act, Section 403 (a) is not present.

In *Provident Land Corp v. Zumwalt,* Appendix p. i, the Supreme Court of California, with reference to this district, said that the land of this district can never be released from the obligation of its bonds until they are paid and that the district only exercises its powers as a trustee for the payment of these obligations. There were only three resident landowners in

the district and therefore nearly all the land of the district is to be held and operated exclusively for the benefit of the bondholders. The court below ignored this declaration of law as to this district.

The *Provident* cases referred to are not only statements of general law applicable to this field, but are adjudications of the facts and law pertaining to this particular district. In passing upon a plan of composition, a bankruptcy court is bound by local law. (*Ginsberg v. Lindel,* 107 Fed. (2d) 721, 725, 726; *American United Mutual Life Ins. Co. v. City of Avon Park,* 108 Fed. (2d) 1010, 61 S. Ct. 157.)

The arrangement to pay the fiscal agent of the district $20,300 is unreasonable in that it is more than 10% of the amount paid to the bondholders.

The district was not shown to be authorized by law (Bankruptcy Act, Sec. 403 (e) (6)) to exclude approximately 10,000 acres under Sections 74 to 84 of the California Irrigation District Act. This land has an apparent value of $7 an acre to the Biological Survey, but the landholders receive nothing from it.

The district has sold 46 parcels of land, 11,294.49 acres, for nearly $10 an acre or approximately $112,000. This money was properly payable to bondholders, since the land was taken by the district for non-payment of taxes, but instead was used to relieve the lands of Reclamation District and county taxes, and to pay interest coupons to January 7, 1931 in full. (R. 104.)

Under the California law, and by practice among the districts, irrigation districts can and this district

does exclusively rent its land to tenants. This practice is more beneficial to the bondholders than sale which produces nothing for the bondholders.

The Bankruptcy Act requires a comparison of total assets to liabilities. (*Cusick v. Second Nat. Bank,* 115 Fed. (2d) 150.) But the district produced no appraisals, no land valuations, no valuations of district property, nor a statement of income and expenditures since its default. No balance sheet or statement of capital assets or income, or financial history was produced. The only evidence on the ability of the district was that of two or three witnesses who were of the opinion the plan is fair.

QUESTIONS PRESENTED.

1. May creditors subsequent in right of payment secure full payment as against 20% payment to one having a vested prior right to payment in full?

2. May a court of bankruptcy disregard the local law applicable to a state agency, declared by the highest court of California?

3. May a court of bankruptcy refuse to follow the facts and law pertaining to this particular district determined and stated by the highest court of California?

4. Is payment of $20,300 to a fiscal agent of a district, such amount being more than 10% of that to be paid to bondholders, reasonable?

5. Is exclusion of land (worth $50,000 to $70,000 and held in trust for bondholders) with no benefit to district or bondholders, fair and equitable?

6. Does approval of a plan of composition require evidence of assets and liabilities, and earning capacity or is mere opinion evidence that it is fair sufficient?

REASONS FOR GRANTING WRIT OF CERTIORARI.

(1) The courts below in this case have decided important questions of law conflicting with local decisions.

The Supreme Court of California in *Provident Land Corp. v. Zumwalt,* supra, decided that bonds of the Provident Irrigation District must be paid in the order of their presentation for payment. In this case the courts below have held that bond obligations later in maturity and presentation for payment should be paid in full while those earlier are to be paid at the rate of 20%. In doing so the bankruptcy court condoned an admitted act of wrongdoing by the district, when it could have righted this wrong by a conditional decree requiring payment in full of Taylor's claim.

The Supreme Court of California decided in *Moody v. Provident Irrigation District,* supra, that bonds of the Provident Irrigation District are not due until funds are available for their payment. In this case the lower courts have held that the Provident Irrigation District is unable to meet its obligations as they mature because it does not have sufficient money on hand.

The Supreme Court of California, in *Provident Land Corp. v. Zumwalt,* Appendix p. i, decided that nearly all the lands of the district are owned by the district and are held by the district in trust, the bondholders being a beneficiary of that trust, and that the land "can never be permanently released from the obligation of the bonds until they are paid". In this case the lower courts have held that the district may secure a loan on the land and remove this trust property from the bondholders, and terminate the bondholders' right to further payment.

(2) The lower courts have decided important questions in conflict with the weight of authority.

The *Erie Railroad v. Tompkins* case, 304 U. S. 64, requires federal courts to follow the law as stated by the state courts.

The cases of *Consolidated Rock Products Company v. Du Bois,* 312 U. S. 510, and *Case v. Los Angeles Lumber Products Co.,* 308 U. S. 106, require evidence and findings on the fairness of a plan based on the assets and earning capacities of a debtor. This should be particularly true of a trust relationship such as we have here, yet the record is without such evidence.

The case of *American Un. Mut. Life Ins. Co. v. City of Avon Park,* 311 U. S. 138, requires inquiry into and reasonableness in payments of fees and expenses in connection with reorganization and composition matters.

Further, settled principles of law require that questions once determined by a court cannot be again ques-

tioned. The doctrine of *res judicata* requires the bankruptcy court to follow the facts and law stated by the Supreme Court of California in the cases referred to which involved this district.

(3) The lower courts have decided an important question of federal law which has not been but should be settled by this Court, this question being whether or not the bankruptcy power extends to reversal of trust declarations made by highest state courts.

(4) The lower courts have decided federal questions in conflict with decisions of this Court.

They have not followed the *Erie Railroad v. Tompkins* case by failure to give effect to the decisions of the Supreme Court of California.

They have disregarded an unreasonable payment made to a fiscal agent contrary to *American Un. Mut. Life Ins. Co. v. City of Avon Park,* supra.

They have given unlawful preference to certain creditors in disregard of principles stated by this Court in *Case v. L. A. Lumber Products Co.,* supra, and *Consolidated Rock Products Co. v. Du Bois,* supra.

Wherefore, petitioners pray that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Ninth Circuit, commanding that Court to certify and to send to this Court for its review and determination a full and complete transcript of the record and of the proceedings of said Court in the case numbered and entitled

in its dockets as "No. 9809, Nelson Taylor, J. R. Mason, Gilbert Moody, and N. O. Bowman, Appellants, v. Provident Irrigation District, Appellee", and that the decree of said Court be reversed by this Court with directions to dismiss the bill, and for such other relief as to this Court may seem proper.

Dated, Turlock, California,
February 2, 1942.

NELSON TAYLOR,
J. R. MASON,
GILBERT MOODY,
N. O. BOWMAN,
Petitioners.

W. COBURN COOK,
Counsel for Petitioners.

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1941

No.

NELSON TAYLOR, J. R. MASON, GILBERT MOODY, and N. O. BOWMAN,
Petitioners,

vs.

PROVIDENT IRRIGATION DISTRICT,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

FACTUAL BACKGROUND OF CASE.

A statement of the facts surrounding the case is made in the preceding petition. Some further facts are recited under the following argument.

I.

THE PLAN IS UNFAIR AND DISCRIMINATORY AS TO PETITIONER NELSON TAYLOR.

His three bonds fell due August 15, 1930 (R. 41) and were presented for payment January 30, 1931, but

never paid. (R. 41.) All other bonds of the same maturity were paid, bonds of later maturities were paid (R. 118), and the plan provides for payment in full of all interest obligations through January 1, 1931. (R. 16.) Taylor's bonds are therefore the *only* bond obligations back of July 1, 1931 which are not paid in full. The fact of this non-payment is one point of discrimination and unfairness. The provision for payment in full of January 1, 1931 coupons is another point of discrimination and preference.

Under California law, bond obligations must only be paid in the order of their presentation for payment. (R. 180.) (Cal. Stat. 1931, p. 172; *Bates v. McHenry,* 123 Cal. App. 81, *Provident Land Corp. v. Zumwalt,* 12 Cal. (2d) 365.)[2] In bankruptcy, relative rights of parties cannot be changed. (*In re Lowmon,* 79 Fed. (2d) 887.)

At the hearing of this case, the non-payment of Taylor's bonds was called an "error" by counsel for the district. (R. 189.) He also stated, "I think it is true there aren't any bonds that are in the class of those three bonds". (R. 182.)

In 1935 two bonds of subsequent maturity (R. 181) and presentation were paid in full and several thousand dollars of interest coupons paid. (R. 118.) Also at various times there was money available for payment of these bonds.

The district declared a "surplus" of $10,000 and went out and bought bonds in the market. This procedure was condemned and set aside in the *Provident*

[2]Appendix p. i.

v. Zumwalt case and the money ordered returned to the bond fund *for payment of bonds and coupons "in the order of their presentation". We thus have an adjudication of the affairs of this district declaring that its bond obligations* must be paid in the order of presentation and the bankruptcy court was without authority to decide otherwise.

Not only did the district fail to pay Taylor's bonds as required, but in 1935 paid two bonds subsequent in date and paid $3120 of interest coupons and $1328.13 interest on registered bonds and coupons. (R. 118.)

In 1939 the district received $5500 of assessments which were also applicable by law to payment of these bonds. (R. 195.)

From time to time it had other moneys applicable to payment of Taylor's bonds. (R. 118, 191.) (*Provident v. Zumwalt,* supra.)

Thus the district, having "surplus" money to buy bonds on the market, deliberately refused for a period of years to pay the bonds first in right wrongfully contending they were "outlawed" even after being reprimanded by the Supreme Court of California for such procedure. (*Provident v. Zumwalt,* Appendix p. i.)

II.

THE HIGHEST COURT OF CALIFORNIA HAS ESTABLISHED THE FACTS AND LAW OF THIS PROCEEDING AND THE BANKRUPTCY COURT WAS BOUND TO FOLLOW SUCH DECISIONS, BUT DID NOT.

In the case of *Moody v. Provident Irrigation District,* 12 Cal. (2d) 389, involving one of the same parties and same bonds as here, the Supreme Court declared that such bonds after presentation for payment do not outlaw and by the act of presentation a new agreement is made whereby bonds are payable only as funds become available and notice is given. The effect is that bonds are not "due" until funds become available.

This matter is therefore *res judicata* as to this district, and the district cannot show that it is insolvent or unable to meet its debts as they mature (as required by the Bankruptcy Act) because there is no maturity until funds are available.

Secondly, the case of *Provident Land Corporation v. Zumwalt* declares that the lands of the Provident Irrigation District "remain in trust and the district exercises its powers, however broad, as a trustee" and the land "can never be permanently released from the obligation of the bonds until they are paid". (See Appendix.)

Thirdly, in the latter case the Supreme Court of California held that the $10,000 wrongfully diverted from payment of bond obligations of the district must be returned and used for payment of bond obligations "in the order of their presentation". The money was

returned but the bankruptcy court is permitting the district to evade that judgment in this proceeding. There are no landowners to save, and the Supreme Court indicates in strong words the reason back of the failure of the district to handle its affairs properly:

> "The true situation seems to be that the directors of the district by their present policy are administering the land for the benefit of lessees who are able to rent the land at exceptionally low prices and for those particular bond holders whose bonds are purchased and retired. The delinquencies have gone too far in this and other districts to save the landowners."

It is reiterated that these decisions were made on the very facts and law involved in this proceeding, and under the rule of *Erie Railroad v. Tompkins,* 304 U. S. 64, the bankruptcy court was bound to follow them. The highest state court is the final authority on state law. (*In re Mt. Forest Fur Farms,* 122 Fed. (2d) 232; *Ginsberg v. Lindel,* 107 Fed. (2d) 721.)

Especial respect should be shown state court decisions involving public lands and the taxing power. (*Wilson v. Standifer,* 184 U. S. 399, 412.)

III.

THE PLAN IS UNFAIR AND DISCRIMINATORY TO PETITIONERS.

(A) The district produced no exhibits of any character showing the assets of the district, showing any balance sheet, any crop returns of the district or containing any financial statement of the affairs of the district whatever. In a bankruptcy proceeding between trustee and beneficiary the confidential relationship, as well as ordinary bankruptcy procedure, require a full disclosure of financial affairs. (*Consolidated Rock Products Co. v. Du Bois,* 312 U. S. 510; *Preble Corp. v. Wentworth,* 84 Fed. (2d) 73.)

(B) Nearly 10,000 acres of land, owned by the district, and held for the benefit of the bondholders, and worth between $50,000 and $100,000, is to be excluded from the district without a cent compensation to bondholders. These lands of the district are held in trust, bondholders being beneficiaries under *Provident Land Corp. v. Zumwalt* (Appendix p. i); *Security First National Bank v. Rindge Land & Nav. Co.,* 85 Fed. (2d) 557.)

(C) The fiscal agent is receiving $20,300 for his services, representing more than 10% of the amount the bondholders are to receive, without disclosure to the court of the reasonableness of the compensation.

(D) The terms of the R. F. C. loan (R. 71, 76) provided that the size of the district was to be reduced from 22,805 acres of land to approximately 13,000 acres and the district was to discharge the lien

of overlapping drainage district indebtedness and to settle county taxes on approximately 12,000 acres of land owned by the district and to apply surplus funds to the reduction of indebtedness due the R. F. C. (R. 73-75.)

There were only three landowners remaining in the district and the district was in fact not only the owner of but was operating the bulk of the acreage of the district as a landlord. (See *Provident v. Zumwalt,* supra, and appendix.)

In *Anderson-Cottonwood v. Klukkert,* 13 Cal. (2d) 191, it was held that where an irrigation district owns land, such land is no longer subject to taxation by the county or other agency because the property is state owned and therefore free from taxation.

The lower court's determination that the titles of the various state agencies taken by tax process are of equal rank may be conceded as correct, but the practice, as the court below would take judicial notice, throughout the state and the facts pertaining to this district show that this district operated these lands as a landlord.

The *Provident v. Zumwalt* decision definitely determined that land rentals secure the bond issues and that the position of the district to the contrary was erroneous. It is in fact *res judicata* that all land rentals in the Provident Irrigation District, after payment of maintenance and operation, are to be applied to bond service. (Appendix p. i.)

Consequently, the reliance of the appellee upon the provisions of Section 3773 of the Political Code of California providing that the state has prior right to possession and sole power to lease and receive rents and profits was not well taken and has no practical application to this district in point of fact.

Furthermore, the plan of this district provides for the sale of all of its lands and as the Attorney General of the state ruled on December 29, 1941, in opinion 2 NS4002, the holder of a tax deed from the state would be a co-owner with the district.

> "If the former owner redeems from the sale to the State, he presumably re-acquires whatever interest the State had in the property. But if the district also has a tax title, or has sold its tax title to a purchaser, there are two claimants to the property and so far as I am able to ascertain the statutes do not determine the relative rights of these claimants. In this connection see La Mesa Irr. Dist. v. Hornbeck, 216 Cal. 730, and South San Joaquin Irr. Dist. v. Neumiller, 2 Cal. (2d) 485."

This opinion goes on to advise the State Controller that where the state has a tax title and an Irrigation District has a tax title, neither has a better title than the other and that

> "notwithstanding the fact that the district has contracted to sell the property to a third person, the former owner has the right to redeem at any time prior to the making and delivering of a deed."

And citing Section 47 of the California Irrigation District Act.

In this state of the law, it would appear that the most feasible plan would have been for the district to continue operating as a landlord and owner of the property, leasing it out, free of state and county taxes, for the sole and exclusive use and benefit of the beneficiaries of the trust declared in the *Provident v. Zumwalt* decision for the benefit of the bondholders.

In practical effect Congress finds itself unable to levy a direct tax on land under the constitution.

This court has said that "there is nothing in the history of bankruptcy reorganization legislation to support the theory that Congress intended to set the federal courts up as super-assessment agencies over State taxes."

Arkansas Corporation Comm. v. Thompson, 313 U. S. 132.

The serious question is raised whether the state can abdicate its powers as trustee of the public lands which the bankruptcy court so unquestionably distributes and disposes in these proceedings—both as regards lands excluded from the district and lands sold out from under the trust.

Secs. 17, 29, 74-80 "the California Irrigation District Act", Stat. Cal. 1897 p. 243 as amended.

Carter v. Carter Coal Co., 298 U. S. 238;

Ill. Centr. R. Co. v. Illinois, 146 U. S. 387, 452.

CONCLUSION.

It is submitted that a writ of certiorari should be granted, the decree of the court below reversed, and the proceeding directed to be dismissed.

Dated, Turlock, California,
February 2, 1942.

Respectfully submitted,
W. COBURN COOK,
Counsel for Petitioners.

(Appendix Follows.)

Appendix

(12 Cal. (2d) 365.)

Provident Land Corporation v. Zumwalt et al.

Sac. 5133.

Supreme Court of California.

Nov. 28, 1938.

As Modified on Denial of Rehearing Dec. 27, 1938.

PER CURIAM.

This is an action by a bondholder to set aside purchases by an irrigation district of its own bonds from other bondholders.

Provident Irrigation District was organized in April, 1918, under the provision of the California Irrigation District Act, Deering's Gen. Laws 1931, Act 3854, p. 1948, with an area of some 22,805 acres. Two bond issues were sold, one in 1918 and the second in 1921, in the total aggregate sum of $1,190,000. In common with most of the other irrigation districts, it suffered considerable delinquencies in its assessments in recent years, and much of the land was taken over by the district for nonpayment. For reasons hereinafter mentioned, this did not relieve the district's financial difficulties, and in January, 1936, its outstanding bonds were in the sum of $900,000, with $152,000 in instalments of principal past due. Unpaid interest coupons in the approximate sum of $225,000 were also past due.

From 1933 to 1936 the district acquired title to over 10,000 acres of land by collector's deed after sale for

delinquent assessments. Being unable to find a buyer for any of the land, it leased a portion of it during these years, and deposited the proceeds in its general fund. On January 7, 1936, the directors passed a resolution declaring that the sum of $10,000 in the general fund constituted a surplus, and ordered that it be set aside for the purchase of bonds of the district in the open market. The secretary was instructed to inform the bondholders that they would be bought from the one making the lowest offer. On February 4, 1936, the district by another resolution purchased from three bondholders, I. G. Zumwalt, defendant herein, the Capital National Bank, and L. M. Benoit, a total of 50 outstanding bonds and attached coupons, of the par value of $1,000 each, for said sum of $10,000.

Plaintiff is the holder of bonds past due in the sum of $86,000 and coupons past due in the sum of $125,000. Its bonds were due and registered prior to those of the aforementioned parties. * * *

* * * * * * *

The ordinary method of payment of bondholders is clearly indicated by these provisions. The directors must levy assessments in a sufficient amount to meet principal and interest payments. If delinquency occurs a higher assessment may be levied thereafter to make up the loss, and meanwhile the district may proceed to sell the land of the delinquent owner and buy it in. If a heavy delinquency occurs, the remaining land bears a correspondingly heavy burden, for every parcel is liable ultimately for the entire bonded indebtedness, and assessments may therefore be

"pyramided" on the land which is not in default. It would ordinarily follow, however, that the land taken in by the district would be resold, and some money would be realized from the sale; and that thereafter the land thus returned to private ownership and liable again for assessments would prove a sufficient source of revenue to keep the assessments at a reasonable figure.

But economic conditions have prevented the working out of this plan in the contemplated manner. Farmers in the agricultural area embraced by various irrigation districts have found it increasingly difficult to meet the obligations of mortgages, taxes and district assessments. When delinquencies began to mount, it became impossible to stop them because of the fact that the remaining land faced continually rising assessments. Moreover, there were no purchasers for the lands taken in by the districts, because a new landowner would immediately become liable for assessments, which could be pyramided to any extent. As a result, some districts now own practically all the land within their boundaries, which they are unable to sell. The land thus owned is of course not subject to assessments, and therefore produces no revenue in this manner. These districts have long been in default in bond payments.

Having title to this enormous acreage which they are unable to sell, these districts have turned to leasing of the land as a means of raising some revenue.

* * *

* * * It may be observed here that the benefit to the landowners resulting from the retirement of any part of the outstanding indebtedness is largely illusory because of the virtual disappearance of the landowner. The true situation seems to be that the directors of the district, by their present policy, are administering the land for the benefit of lessees who are able to rent the land at exceptionally low prices, and for those particular bondholders whose bonds are purchased and retired. The delinquencies have gone too far in this and other districts to save the landowners.

* * * * * * *

The position of defendants is that the district has fulfilled its entire duty to the bondholders by levying assessments and selling the land for delinquency. * * *

* * * * * * *

Although the question is a difficult one upon which we find no directly controlling authority, we are unable to agree with defendants' position which, as already pointed out, has the effect of giving a preference to bondholders inferior in right, and may result in a complete cessation of any payments to bondholders generally. Defendants place such strong reliance upon the language of amended sections, particularly sections 47 and 52, supra, that a problem of constitutionality is suggested by what may appear to be a legislative impairment of substantial rights of bondholders. But upon a careful examination of the act as a whole, we have concluded that the real issue is rather one of interpretation. In our opinion, the statute was intended to secure the bonds by the proceeds of the land in the district. It is true that the bonds themselves

are not a lien on the land. But the assessment is a lien (sec. 40), and the district is required to collect the assessment or sell the land. Land coming into other private ownership is again liable for assessments (sec. 33), and land in possession of the district should, if possible, be sold again, so that it may produce the required revenue. There is nothing in the nature or the terms of the act which sanctions the extraordinary procedure attempted herein, where the holders of matured bonds are unpaid, and the only revenue produced by the land is diverted to a few selected holders of unmatured bonds. It is no answer to say that with legislative aid, the legislation being subsequent to the making of the bondholders' contract, a classification of "funds" has been made, and a method of declaring a "surplus" has been devised, with the effect of destroying the sole intended source of payment of the bonds. We do not understand how a debtor owing $360,000, long overdue, can have a surplus of $10,000. Nor do we understand how the district can be entitled to take all of the money derived from the land, whether by sale or lease, and use it for purposes other than payment of the primary obligations of holders of overdue bonds. It is within the discretion of the directors to use some portion of it for running expenses, and where this use is necessary, their discretion will be upheld on familiar principles. But when the directors themselves declare that a surplus exists, over and above the operating needs of the district, two things should be clear: first, that this money should go to the bondholders; and second, that in any event, it should not be given to junior bondholders in prefer-

ence to those with prior claims but should be paid on past due bonds and coupons in the order of their presentation. And to reach this conclusion we need not find any express direction setting forth the exact procedure in the statute. The situation is one not contemplated by the act, not covered by any clear provision, and calls for a construction of its general provisions in the light of equitable principles.

These principles find an appropriate foundation in section 29 of the act, which provides that property acquired by the district under its provisions shall be held "in trust for, and is hereby dedicated and set apart to the uses and purposes set forth in this act". This express statement that the lands are impressed with a trust must be kept in mind in considering the amendment to section 47, purporting to give the district the rights of a private purchaser. Reading the two sections together, the only reasonable interpretation is that the district may freely transfer, lease or otherwise deal with the lands, in so far as its power is concerned, but the lands remain in trust, and the district exercises its powers, however broad, as a trustee. Once it is made clear that the lands are held in trust, it necessarily follows that their proceeds, whether by sale or lease, are likewise subject to the trust. It would be manifestly absurd to say that although property is held in trust, none of the benefits of the trust accrue to the beneficiaries, and that none of the rents or profits of the trust property need be used in furtherance of the trust purposes. On this point, namely, that the land is trust property, held for the "uses and purposes" of the act, and that the proceeds

are stamped with the character of the property from which they flow, the statute, read in the light of elementary principles, leaves no room for debate.

It next becomes necessary to determine whether payment of the bondholders is one of these purposes. On this question defendants and amici curiae vigorously contend that the purposes of the act are to construct irrigation works, and provide for irrigation of the lands of the district. They concede that the district is authorized to borrow money for these purposes, but assert that creation of debts is not one of its purposes. They concede that the act requires repayment of the money borrowed, but assert that this is not one of its purposes. This type of argument, however, tends to prove too much, for it is difficult to conceive of the legitimate use of any funds of the district, derived in any manner, for something which is not a purpose of the district. How can the assessments, when collected, be paid to bondholders, if payment of their obligations is not a purpose of the act? If the bond fund was not created to carry out a purpose of the act, for what purpose was it created? But laying aside quibbles as to the exact meaning of the phrase "uses and purposes", it seems clear that if the district is to be created and to function on borrowed money, repayment of the money is not a wholly immaterial and foreign objective. Evading creditors is not a contemplated activity of a public district, whose bonds are recognized investments for financial institutions. Among other purposes of the act, therefore, is the repayment of the bondholders of the dis-

trict, and it follows that this is one of the purposes for which the trust money is held.

This view is fortified by a consideration of the general plan of the statute, in so far as it provides for the creation of an obligation and a procedure for payment. The land is the ultimate and only source of payment of the bonds. It can never be permanently released from the obligation of the bonds until they are paid. The release from liability for assessments while the district holds title is intended to be temporary only, and the liability for new assessments is again imposed when it goes back into private ownership. Any practice which removes the land from its position as ultimate security for the bonds, or which places its proceeds beyond the reach of the bondholders, destroys that plan and is contrary to the spirit of the act. And the practice employed by the district herein does exactly that. Theoretically and formally, the remedies of the bondholders remain unaltered. Actually, they have been destroyed. Economic conditions have placed the land itself outside of the power of assessment for payment of the bonds. But it is the act of the directors alone which has taken the proceeds of the land from the bondholders. This use of funds, contrary to the whole intent of the act, is in our opinion in violation of the trust impressed on the land under section 29. We do not mean to hold, nor is it contended by plaintiff, that the entire proceeds are held in trust for bondholders. Payment of the bonds is but one of the purposes of the trust. The land may also be a source of funds to enable the dis-

trict to function. It is true that another important method of raising operating funds exists, namely, the charging of tolls for the use of water (secs. 39 and 55 of the act), a practice said to be successfully employed in some districts. Whether any duty exists to levy such tolls so that money from rentals might go in full to the bondholders is not an issue in the instant case. We assume, for the purposes of this case, that the directors, in their discretion, may determine that some of the proceeds of leasing of lands are essential to operation and maintenance, and may use them for these purposes. But any surplus, over and above operating expenses, remains subject to the trust, and should go to the payment of bondholders.

The foregoing discussion disposes of such cases as Mulcahy v. Baldwin, supra, 15 P.2d 741, wherein the statement is made: "The declared plan of the Irrigation District Act is that the holders of outstanding bonds of the district have the right to enforce their demands solely by an annual assessment on the lands in the district. Such is their contract." And it is further declared that "in law purchasers of those bonds could look only to the statutory right of assessment and enforced payment under that method of raising revenue". These remarks, obviously correct as a definition of the rights of bondholders in situations within the contemplation of the framers of the act, offer no solution for the entirely new problem which confronts us. We held in the Mulcahy Case that the bondholder was not entitled to reach certain special funds, not derived from the land itself but from con-

tracts for the sale of power; and we said that he could "enforce" payment under the assessment method. But suppose the assessment method has disappeared as a means of collecting revenue; can the bondholder "enforce" payment? He has a right to enforce making and payment of assessments under one part of the statute, but there are virtually no lands to assess; by reason of acts taken under other provisions of the statute the assessable land has been completely taken from him, and is now beyond the reach of this remedy. In this situation it would be unreasonable to say that the bondholder's only remedy is to have an assessment levied. We must take a practical view of the circumstances, and recognize that where there are no assessable lands, there is no remedy of assessment. The quoted excerpts from Mulcahy v. Baldwin are not, therefore, an obstacle to the application of the principles which we have already discussed. If there is any doubt as to the propriety of this interpretation of the holding of that case, it may be set at rest by an examination of our late decision in Kerr Glass Manufacturing Corp. v. San Buenaventura, 7 Cal.2d 701, 62 P.2d 583, where we recognized the justice of applying equitable principles to the payment of bondholders in unusual circumstances, notwithstanding the fact that express provisions of the statute stood in the way We call attention to this significant statement on page 710 of that decision, 62 P.2d on page 587: "The trust status of the fund has been considered appropriate where it is theoretically replenishable by a so-called inexhaustible taxing power, but the exercise of that power is rendered fruitless by reason of

economic conditions resulting in a tax-collecting incapacity." In the same sense the bond fund in the instant case is theoretically replenishable by the unlimited power of assessment, but in fact that power is gone because the subject of the assessment, the land, is removed from its reach.

It follows that if the allegations of the complaints are true, the purchases of the bonds from the various defendants were unauthorized, and the sales must be set aside, and the consideration returned to the parties.

The judgment is reversed with directions to the trial court to overrule the demurrers and permit defendants to answer if they deem it advisable to do so.

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1941

No. 934

NELSON TAYLOR, J. R. MASON, GILBERT MOODY, and N. O. BOWMAN,
Petitioners,

vs.

PROVIDENT IRRIGATION DISTRICT
(an Irrigation District),
Respondent.

RESPONDENT'S REPLY TO PETITION FOR WRIT OF CERTIORARI to the United States Circuit Court of Appeals for the Ninth Circuit and to BRIEF IN SUPPORT THEREOF.

GEORGE R. FREEMAN,
ELMER LAINE,
Willows, California,
Counsel for Respondent.

PERNAU-WALSH PRINTING CO., SAN FRANCISCO, CALIFORNIA

Subject Index

Page

Statement of the Case 1

I.

Answer to first proposition: "The plan is unfair and discriminatory as to petitioner Nelson Taylor" 2

II.

Answer to second proposition: "The highest court of California has established the facts and law of this proceeding and the bankruptcy court was bound to follow such decisions, but did not" 4

III.

Answer to third proposition: "The plan is unfair and discriminatory to petitioners" 4

(A) Assets of the district, etc. 4

(B) Excluded lands 5

(C) Fiscal agent's fee 6

(D) Operation of district lands by district 6

Conclusion 7

Table of Authorities Cited

Cases Pages

Bates v. McHenry, 123 Cal. App. 81 2

Bekins v. Lindsay-Strathmore Irr. Dist., 114 Fed. (2d) 680 4

Jordan v. Palo Verde Irr. Dist., 114 Fed. (2d) 691, certiorari denied, 61 S. Ct. 712 4

Moody v. James Irrig. Dist., 9 Cir., 114 F. 2d 685 3

Provident Land Corp. v. Zumwalt, 12 Cal. (2d) 365 2

West Coast Life Ins. Co. v. Merced Irr. Dist., 9 Cir., 114 F. (2d) 654 ..... 3, 4

Statutes

California Irrigation District Act, Section 52 2

Cal. Stat. 1931, p. 172 2

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1941

No. 934

NELSON TAYLOR, J. R. MASON, GILBERT MOODY, and N. O. BOWMAN,
Petitioners,

vs.

PROVIDENT IRRIGATION DISTRICT (an Irrigation District),
Respondent.

RESPONDENT'S REPLY TO PETITION FOR WRIT OF CERTIORARI to the United States Circuit Court of Appeals for the Ninth Circuit and to BRIEF IN SUPPORT THEREOF.

To the Honorable Harlan Fiske Stone, Chief Justice of the United States, and to the Associate Justices of the Supreme Court of the United States:

STATEMENT OF THE CASE.

Counsel has, in his petition for a writ of certiorari, made a very cursory statement of the facts involved in

this case and in several instances has distorted the facts appearing in the record.

The facts are comprehensively reviewed by the opinion of the Circuit Court of Appeals, Ninth Circuit, reported in 123 Fed. (2d) 965, at pages 965 and 966, and we respectfully refer this Honorable Court thereto.

The petition purports on pages 8 and 9 thereof to present six questions for determination, but in the brief in support thereof three propositions are argued which we will answer in the order followed:

I.

ANSWER TO FIRST PROPOSITION: "THE PLAN IS UNFAIR AND DISCRIMINATORY AS TO PETITIONER NELSON TAYLOR".

The contention of petitioner Nelson Taylor is based upon the erroneous premise that by reason of the presentation and endorsement of his bonds after they matured in accordance with Section 52 of the California Irrigation District Act, he was entitled to a preference on the ground that under "California law, bond obligations must only be paid in the order of their presentation for payment. (R. 180.) (Cal. Stat. 1931, p. 172; *Bates v. McHenry,* 123 Cal. App. 81, *Provident Land Corp. v. Zumwalt,* 12 Cal. (2d) 365.)" (Petitioner's Brief, pp. 5-7; 14.)

This contention was answered by the Circuit Court of Appeals as follows (123 Fed. (2d) 967):

> "* * * The Bankruptcy Act places on a basis of equality all existing creditors whose claims are payable from the same source, and in the event of bankruptcy the bonds of the district of whatever maturity, and whether they have been registered or not, are on a parity. West Coast Life Ins. Co. v. Merced Irr. Dist., 9 Cir., 114 F. (2d) 654, Moody v. James Irrig. Dist., 9 Cir., 114 F. 2d 685."

In the cases cited by the Circuit Court of Appeals the question was comprehensively considered and both of the cases cited by petitioner, together with a number of other cases, clearly distinguished. In the *Moody* case, supra (114 Fed. (2d) 685, 688), the Court stated:

> "* * * we decided in the Merced case that due bond interest and principal does not become preferred claims when presented and registered as provided by Section 52 of the California Irrigation District Act. Had the District proceeded in its course as a solvent entity the holders of overdue bonds and interest would have been paid in accordance with Section 61a of the California Irrigation District Act. But it did not and could not have so proceeded, and it resorted to the Bankruptcy law for relief."

Certiorari was denied by this Court in both the *West Coast Life Ins. Co.* case and the *Moody* case, supra (61 S. Ct. 441, rehearing denied, 61 S. Ct. 620, 61 S. Ct. 721.)

II.

ANSWER TO SECOND PROPOSITION: "THE HIGHEST COURT OF CALIFORNIA HAS ESTABLISHED THE FACTS AND LAW OF THIS PROCEEDING AND THE BANKRUPTCY COURT WAS BOUND TO FOLLOW SUCH DECISIONS, BUT DID NOT".

The Supreme Court of California has not had anything to do with the "facts and law of this proceeding" and the contention of counsel that the lands of the District "remain in trust" and that "the land 'can never be permanently released from the obligation of the bonds until they are paid'" is fully answered by the Circuit Court of Appeals and supported by the following cases:

West Coast Life Ins. Co. v. Merced Irr. Dist., supra (114 Fed. (2d) 654, 675-676);

Jordan v. Palo Verde Irr. Dist., 114 Fed. (2d) 691, 694, 696, certiorari denied, 61 S. Ct. 712;

Bekins v. Lindsay-Strathmore Irr. Dist., 114 Fed. (2d) 680, 683, 684.

III.

ANSWER TO THIRD PROPOSITION: "THE PLAN IS UNFAIR AND DISCRIMINATORY TO PETITIONERS".

(A) Assets Of The District, etc.:

This contention of petitioners is answered by the Circuit Court of Appeals as follows (123 Fed. (2d) 967):

> "It is claimed that the record discloses no valuation data sufficient to enable the trial court to reach a conclusion as to the fairness of the plan. There was, it is said, no appraisal of the assets

of the district, no balance sheet or statement of assets or income. But remembering that the proceeding has to do, not with a private bankrupt, but with an agency of government, we think the showing was adequate and sufficiently complete. The assets to which creditors might resort consisted in this instance of such cash as the district had and its interest in the lands acquired; and of these and their worth the court was fully advised."

(B) Excluded Lands:

On page 18 of petitioners' brief, the wholly unsupported statement is made that nearly "10,000 acres of land, owned by the district, and held for the benefit of the bondholders, and worth between $50,000 and $100,000, is to be excluded from the district without a cent compensation to bondholders".

This contention of petitioners is answered by the Circuit Court of Appeals as follows (123 Fed. (2d) 967):

> "* * * Appellants suggest that these lands might be sold to the Biological Survey at prices ranging from $7 to $15 per acre. The evidence is that they are worth no more than $5 an acre with no tax obligation against them; but even if they could be sold for three times as much the sum realized would be far short of the amount necessary to discharge existing liens in favor of taxing bodies other than the district itself."

The debt burden of Reclamation District No. 2047 and the delinquent county taxes against the excluded lands amount to a total of $339,972.04. (R. 100.)

(C) Fiscal Agent's Fee:

No objection to the amount paid to the fiscal agent of the District was made in the District Court and the evidence fully supports its reasonableness. The services rendered extended over a period in excess of four years and the fiscal agent paid all of his own costs and expenses from the amount paid him. (R. 112-113.)

(D) Operation Of District Lands By District:

On page 18 to 21 of petitioners' brief, it is suggested that the District should have continued to lease its lands as a landlord, keeping it off tax rolls and paying no part of governmental expenses in lieu of refinancing.

This contention of counsel is fully answered by the Circuit Court of Appeals as follows (123 Fed. (2d) 967, 968):

> "* * * Appellants argue * * * that the district might continue to lease these lands, and in effect operate them for the benefit of the bondholders. They would be tax free, it is said, and altogether a rosy picture is conjured up. However, serious flaws in this program at once suggest themselves. Prior to the reorganization the district was not sole owner of the lands; title to them was jointly in the district, Reclamation District No. 2047 and the state. We take it that all of these titles are of equal rank, La Mesa, etc. Irr. Dist. v. Hornbeck, 216 Cal. 730, 17 P. 2d 143, but under section 3773 of the Political Code of California the state would seem to have prior right to possession and the sole power to lease and to receive the rents and profits. Counsel for appellants tell us that

in many districts similarly situated it is the practice of the district to take all the rentals; but as a permanent program, considered with all its implications, we are not impressed with counsel's alternative to composition."

CONCLUSION.

In conclusion we submit that the petition for a writ of certiorari should be denied as there are no important legal questions presented which have not heretofore been firmly established and the decision of the Circuit Court of Appeals is in accord with the law as heretofore announced by this and other Federal and State Courts upon the subject in question.

Dated, Willows, California,
March 9, 1942.

Respectfully submitted,
GEORGE R. FREEMAN,
ELMER LAINE,
Counsel for Respondent.